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No. 01-1311

IN THE

Supreme Court of the United States

MILWAUKEE SAFEGUARD INSURANCE COMPANY, *et al.*,
Petitioners,

v.

STEPHEN F. SELCKE, Director of the Illinois Department of Insurance, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the Appellate Court of Illinois, First Judicial District

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND BRIEF *AMICUS CURIAE* COUNCIL ON STATE TAXATION IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE*

The Council On State Taxation ("COST") respectfully requests leave to file a Brief as *Amicus Curiae* in support of Petitioners. The interest of COST as *amicus curiae* is described *infra* at Brief, pp. 1-3. Counsel for Petitioners have consented to COST's filing of an *amicus* brief. Despite COST's qualifications to submit an *amicus* brief, Counsel for Respondents have refused to consent to the filing of such a brief. However, in the absence of such permission there are at least two reasons for granting this request.

First, with respect to the Petition filed in this case, COST has additional observations to make concerning the constitutional implications of Illinois' denial of meaningful backward looking relief. While the Petitioners represent the

views of the insurance industry in this regard, COST's membership includes companies from all industries and, accordingly, COST seeks to raise issues facing all multistate taxpayers as a result of the decision below. A full exposition of the controversy of this case by interested and eligible *amicus* is ultimately to the benefit of the Court in its administration of writs for certiorari.

Second, all COST members are concerned with Illinois' interpretation of the constitutional standard by which states are judged in providing a remedy for their discriminatory tax imposition. Having ignored this Court's mandate in *McKesson Corp. v. Div. of Alcoholic Beverages and Tobacco, Dept. of Business Regulation,* 496 U.S. 18, 31 (1990), Illinois' failure to consent to the filing of an *amicus* brief is not suprising. While Petitioners have done an excellent job of supporting the Petition for a Writ of Certiorari, COST adds the perspective of a broader group of business concerns. Accordingly, COST asks the Court to grant the present motion.

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
INTEREST OF *AMICUS CURIAE*	1
ARGUMENT	3
I. ILLINOIS DENIES THE RIGHTS AND REMEDIES GUARANTEED AS A MATTER OF DUE PROCESS BY FAILING TO PROVIDE ANY MEANINGFUL BACKWARD-LOOKING RELIEF OR A CLEAR AND CERTAIN REMEDY FOR THE STATE'S UNCONSTITUTIONAL IMPOSITION OF TAX	3
II. ILLINOIS IMPOSES BURDENS ON TAXPAYERS NOT TOLERATED BY THE COMMERCE CLAUSE, REGARDLESS OF WHETHER THE BURDEN OF THE TAX WAS PASSED-ON	8
III. THE ILLINOIS DECISION ENCOURAGES STATES TO IMPOSE AND COLLECT ILLEGAL AND DISCRIMINATORY TAXES	9
IV. THIS COURT SHOULD ESTABLISH A BRIGHT-LINE LEGAL INCIDENT RULE IN PLACE OF THE NON-STATUTORY PASS-ON DEFENSE	11
CONCLUSION	12

TABLE OF AUTHORITIES

CASES Page

Atchison, T. & S. F. R. Co. v O'Connor, 223 U.S. 280 (1912) 5

Colonial Coal Company, Inc. v. United States, Case No. 01-427-T (Fed. Claims) 3

Hanover Shoe, Inc. v. United Shoe Machinery Corp., 392 U.S. 481 (1968) 6

Pittsburgh & Midway Coal Mining Co. v. Ariz. Dept. of Revenue, 161 Ariz. 135, 776 P.2d 1061 (1989) 10

McKesson Corp. v. Div. of Alcoholic Beverages and Tobacco, Dept. of Business Regulation, 496 U.S. 18 (1990) 2, 4, 5, 6, 9

Milwaukee Safeguard Insurance Co. v. Selcke, 179 Ill. 2d 94, 688 N.E. 2d 68 (1997) 4

Milwaukee Safeguard Insurance Co., No. 93 L 50663, etc., (consolidated), Appellate Court Order, July 17, 2001 ..... 4, 7, 10

United States v. Jefferson Elec. Mfg. Co., 291 U.S. 386 (1934) 4

UNITED STATES CONSTITUTION

U.S. Const. Amend. XIV, § 1 ..... *passim*

STATUTES

McCarran Ferguson Act, 59 Stat. 33, 15 U.S.C. § 1011 8

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BRIEF *AMICUS CURIAE* COUNCIL ON STATE TAXATION IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

INTEREST OF THE *AMICUS CURIAE*

The Council On State Taxation (COST) submits this brief as *amicus curiae* in support of Petitioners in the above captioned matter.[1] COST is a non-profit trade association organized in 1969 as an advisory committee to the Council of

[1] No counsel for a party authored this brief in whole or in part, and no person or entity, other than *amicus curiae*, has made a monetary contribution to the preparation or submission of this brief.

State Chambers of Commerce.[2] COST, which was separately incorporated on January 1, 1992, has a membership of over 540 multistate corporations involved in interstate and international commerce. COST's objective is to preserve and promote equitable and nondiscriminatory state and local taxation of its members and all multi-jurisdictional business entities.

The present case involves Illinois' discriminatory taxation of out-of-state insurance companies. As with many other unconstitutional state tax structures, Illinois imposed its tax only on out-of-state insurers, a number of which are COST members. In 1997, as part of this litigation, the Illinois Supreme Court determined that the State's Privilege Tax was unconstitutional.[3] Five years later the State continues to add insult to injury, refusing to refund the money collected illegally from the litigants. This case questions the constitutional standard by which states are judged in providing a remedy for their discriminatory tax imposition and as such is at the core of COST's mission.

COST is particularly concerned that Illinois has unconstitutionally taken money from taxpayers, and refused to return it, based on a theory rejected by this Court in *McKesson Corp. v. Div. of Alcoholic Beverages and Tobacco, Dept. of Business Regulation,* 496 U.S. 18, 31 (1990). Illinois ignores *McKesson,* relying on the pass-on defense as justification for its failure to provide a meaningful remedy. The State uses the pass-on defense as a bar to the taxpayers'

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[2] COST was previously the Committee On State Taxation but changed its name to the Council On State Taxation by vote of its membership November 6, 2001.

[3] In 1998 the Illinois legislature repealed the unconstitutional tax and adopted a new, nondiscriminatory tax on insurance companies doing business in the State. Unfortunately, the legislature only solved the problem prospectively leaving the courts to fashion the remedy for past discrimination.

constitutionally based claim to meaningful backward looking relief. Illinois' assertion of the pass-on defense here denies the taxpayers any meaningful backward-looking relief or clear and certain remedy.

COST is also concerned that, left unchecked, the Illinois decision creates perverse incentives that will distort the fair and efficient administration of tax. The decision allows states to violate constitutional protections without having to provide a meaningful remedy. Without a requirement of reparation, states have no financial incentive to pass legitimate laws. A healthy fear of fiscal disruption, on the other hand, leads to better governance and fairer treatment of taxpayers in and outside the state. Businesses nationwide are concerned that Illinois' approach is and will continue to spread to other taxes and other taxing jurisdictions.[4] Failure to review this blatant evisceration of constitutional protections will, especially in tight fiscal times, embolden the latest efforts to erode constitutional principles.

ARGUMENT

I. ILLINOIS DENIES THE RIGHTS AND REMEDIES GUARANTEED AS A MATTER OF DUE PROCESS BY FAILING TO PROVIDE ANY MEANINGFUL BACKWARD-LOOKING RELIEF OR A CLEAR AND CERTAIN REMEDY FOR THE STATE'S UNCONSTITUTIONAL IMPOSITION OF TAX.

Petitioners seek a refund of the Illinois insurance premium Privilege Tax unconstitutionally collected from out-of-state

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[4] Even the United States Department of Justice has recently cited the decision below in its effort to extend Illinois' theory to the many Black Lung Excise Tax refund suits pending in the Court of Federal Claims. *See Colonial Coal Company, Inc. v. United States*, Case No. 01-427-T (Fed. Claims), Joint Preliminary Status Report.

insurers.[5] Despite the State Supreme Court's holding that the tax was unconstitutional, Illinois seeks to limit taxpayers to prospective relief, refusing to provide retroactive relief to taxpayers who paid the tax under protest. At issue then is the State's effort to raise the pass-on defense to prevent taxpayers from recovering the illegal exaction, arguing that retroactive relief is unnecessary because taxpayers may have been able to pass on some or all of the illegal tax to their customers.

Due Process requires the State to return Petitioners' Privilege Tax payments—a tax imposed directly on Petitioners—regardless of whether they passed the tax on to their customers. *McKesson,* 496 U.S. 18. The United States Supreme Court, while acknowledging that the pass-on defense may be appropriate in certain refund suits, rejected use of the pass-on defense when the State was "attempt[ing] to avoid bestowing [a] so-called 'windfall' when redressing a tax that is unconstitutional because discriminatory." *Id.* at 47.[6] The logic and holding of *McKesson* in this regard seems to have completely escaped the Illinois Appellate Court, which reasons around *McKesson* and holds that taxpayers have the burden to prove that they did not pass on the tax to another party and thus will receive no windfall. *Milwaukee Safeguard Insurance Co.*, No. 93 L 50663, etc., (consolidated), Appellate Court Order at p. 18, July 17, 2001. The State's effort to retain illegally gotten tax revenue violates the basic tenets of Due Process which require "meaningful backward-looking relief" to rectify unconstitutional discrimination. *McKesson*, 496 U.S. at 31. The Illinois Appellate

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[5] The Illinois Supreme Court found that the Privilege Tax violated the uniformity clause of the Illinois Constitution. *Milwaukee Safeguard Insurance Co. v. Selcke*, 179 Ill. 2d 94, 104-05, 688 N.E. 2d 68 (1997).

[6] This Court has only permitted use of the pass-on defense in cases involving remedies for nondiscriminatory taxation. *See, e.g., United States v. Jefferson Elec. Mfg. Co.*, 291 U.S. 386 (1934).

Court's failure to protect Petitioners' Due Process rights, in complete disregard of *McKesson*, calls for review by this Court.

States must provide "a fair opportunity to challenge the accuracy and legal validity of their tax obligation" and a "'clear and certain remedy' for any erroneous or unlawful tax collection to ensure that the opportunity to contest the tax is a meaningful one." *Id.* at 39, citing *Atchison, T. & S. F. R. Co. v O'Connor*, 223 U.S. 280, 285 (1912). Although Illinois has provided the Petitioners an opportunity to successfully challenge the legal validity of the Privilege Tax, the State has failed to provide them the clear and certain remedy to which they are constitutionally entitled. To deny Petitioners their refund of the discriminatory tax based on the pass-on defense makes meaningless their ability to challenge the unlawful tax. Years of tax payments were collected under protest while the taxpayers' challenge to the legitimacy of the tax was litigated. Having lost the case, the State raised the pass-on defense as a last resort to avoid refunding unconstitutional taxes. Fortunately, this Court has already held that Due Process requires that the State provide taxpayers with *meaningful* backward looking relief. *McKesson*, 496 U.S. at 31. The United States Supreme Court has described the relief required in discrimination cases and has said that the State may: (1) grant taxpayers a refund of the illegal tax; (2) assess favored taxpayers putting both groups on an even competitive field; or (3) provide for a combination of refunds and assessments to create equality of treatment. *Id.* at 40-41. Illinois has done none of these. The State has simply fought to deny Petitioners retroactive relief, arguing instead that the taxpayers should be required to establish that pass-on of the tax did not occur. By using a procedural roadblock the State fails to provide the clear and certain remedy that the Constitution requires and the United States Supreme Court has demanded.

This Court held in *McKesson* that meaningful backward looking relief exists where the State refunds the illegal tax, imposes an equalizing tax on the favored class, or provides a combination of refunds and assessments to level the playing field. *Id.* at 40-41. The State ignores that decision by failing to provide *any* remedy. The State has not attempted to retroactively assess favored class members even though the Illinois legislature repealed the discriminatory tax replacing it prospectively with a nondiscriminatory tax on foreign and domestic insurers. The Constitution requires more from the State than the prospective acceptance that it was wrong. It must make the past right in constitutional terms. Failure to provide any retroactive relief leaves these taxpayers, and all future challengers to illegal exactions by any state, in the position of mounting a challenge with no possibility of recovery. Uncorrected, the Illinois decision is a recipe for further illegal taxation.

The Appellate Court's decision improperly puts the burden on taxpayers to prove that they did not pass on the economic burden of the tax to their customers. By doing so, the State attempts to create an impossible burden for taxpayers seeking a refund of a discriminatory tax. This aspect of the decision is particularly troublesome in that it recites and then ignores the Court's warning in *McKesson*, that "determining whether a particular business cost has in fact been passed on to customers or suppliers entails a highly sophisticated theoretical and factual inquiry. . ." *McKesson,* 496 U.S. at 47. *McKesson* further noted that such inquiry "would often require additional long and complicated proceedings involving massive evidence and complicated theories." *Id.*, citing *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481, 493 (1968). A taxpayer's entitlement to a refund of an illegally collected tax should not require the taxpayer to engage in the type of expensive factual litigation foreshadowed by *McKesson*. If money was extracted unconstitutionally from a taxpayer, it should be returned, without

imposition of this expensive and time-consuming burden. The State's failure to provide a refund in this context is no meaningful remedy.

As if the denial of Petitioners' Due Process were not bad enough, the Appellate Court's decision threatens to impact the Due Process rights of all taxpayers. The decision opens the door for this rationale to be applied to *any* tax and *any* taxpayer stepping foot in the State of Illinois, or any state using Illinois' argument. This decision is important, therefore, not just to the insurance industry, but to all taxpayers based in Illinois or doing business there from outside the State. Application of the pass-on defense is not limited to the Privilege Tax, and arguably applies to any tax imposed by the State. The Appellate Court grants, "the parties [the] discretion to choose whether to raise the pass-on defense," with respect to any tax. *Milwaukee Safeguard*, Appellant Court Order at p. 17. Some taxes, like the Illinois Use Tax, are clearly impositions statutorily collected from customers. Others, like the Illinois Corporate Income Tax are clearly imposed directly on the business. The Appellate Court fails to liken the Privilege Tax to either; in fact, the Privilege Tax is not collected from customers and operates more like the income tax in that it is imposed on the entity and its calculation depends on factors beyond the premiums charged to insured customers. Where, as here, the vendor is not statutorily allowed to pass through the burden of the tax, the evidentiary burden involved in proving the negative, that the tax was not passed through to customers, is nearly insurmountable.

Taking this logic to its conclusion, the decision can be read to prevent a business taxpayer from recovering an income tax overpayment, even when the overpayment was caused by a mathematical error, if the taxpayer fails to prove that it did not pass on the cost of its income tax liability to customers. This short-sighted and absurd view fails to recognize that all costs of doing business, including income taxes, must in some

sense over time be passed on to customers for a business to remain profitable and thus stay in business. A profitable business would therefore never be able to obtain a refund of *any* unconstitutionally collected tax. Such a holding creates an incentive for States to ignore constitutional limits on taxation and for businesses to underpay their tax liability as protection against the inability to obtain refunds. As a result, the decision has serious implications for taxpayers and state treasuries alike. In sum, the holding has perverse and potentially widespread ramifications that must be brought into check by this Court.

II. ILLINOIS IMPOSES BURDENS ON TAXPAYERS NOT TOLERATED BY THE COMMERCE CLAUSE, REGARDLESS OF WHETHER THE BURDEN OF THE TAX WAS PASSED ON.

Although the decision below did not reach Commerce Clause issues (but held the Privilege Tax violated the uniformity clause of the Illinois Constitution), the tax structure unquestionably violates Commerce Clause principles, as the tax was imposed on out-of-state but not in-state companies.[7] The inordinate burden on out-of-state companies would create a violation of the Commerce Clause, which clearly prohibits putting out-of-state companies at such a competitive disadvantage. This disadvantage remains even if the out-of-state companies are able to pass on the tax burden to their customers. As recognized by *McKesson*,

> "[t]he tax injured petitioner not only because it left petitioner poorer in an absolute sense than before (a

[7] The insurance industry does not have Commerce Clause protection as a result of the federal McCarran-Ferguson Act, 59 Stat. 33, 15 U.S.C. § 1011. Thus, the court below did not consider the Commerce Clause issues. Expansion of the State's theory to other taxes or other taxpayers would implicate Commerce Clause principles directly.

problem that might be rectified to the extent petitioner passed on the economic incidence of the tax to others), but also because it placed petitioner at a relative disadvantage in the marketplace vis-à-vis competitors distributing preferred local products." *McKesson* at 48. "The State cannot persuasively claim that "equity" entitles it to retain tax moneys taken unlawfully from petitioner due to its pass-on of the tax where the pass-on itself furthers the very competitive disadvantage constituting the Commerce Clause violation that rendered the deprivation unlawful in the first place. We thus reject respondents' reliance on a pass-on defense in this context." *Id.*

It is clear that the State subjected Petitioners to discriminatory taxation in violation of Commerce Clause principles (but for the application of the McCarran Ferguson Act). It is also clear that Petitioners were subject to a competitive disadvantage even if the tax was passed on to their insured customers. Failure to provide any remedy for what amounted to a Commerce Clause violation results in a denial of Due Process. *McKesson* holds that Due Process requires the State to return the tax payments regardless of whether Petitioners or any other taxpayer passed the tax on to their customers. *Id.* at 18.

III. THE ILLINOIS DECISION ENCOURAGES STATES TO IMPOSE AND COLLECT ILLEGAL AND DISCRIMINATORY TAXES.

Failing to require any state to return that which it took in violation of the Constitution is tantamount to encouraging the state to thwart the law and Constitution without fear of reprisal. If the only consequence of imposing an illegal tax is, eventually, having to stop, there is little incentive for legislators to craft their tax measures more thoughtfully. A healthy fear in the disruption of the state treasury will discourage the temptation to export the tax burden by

imposing unconstitutional burdens on interstate commerce. Free from this fear, as soon as one measure is declared unconstitutional the state is undeterred from adopting another. Repeated taxpayer challenges, rewarded not by refund of the illegally gotten gains but by yet another discriminatory tax, will yield the "home field" advantage the Commerce Clause was designed to eliminate. Rather than follow the bright-line rule of *Mckesson*, the State attempts to cloak itself from liability by hiding behind the pass-on defense. This approach, should it be allowed to stand, rewards stealth and cunning over candid, fair, and disciplined state taxation.

It is imperative that the State here be required to remedy its wrongs with refunds. "An honorable government would not keep taxes to which it is not entitled. . ." *Pittsburgh & Midway Coal Mining Co. v. Ariz. Dept. of Revenue*, 161 Ariz. 135, 139, 776 P.2d 1061, 1065 (1989). This Court should review the Illinois court's decision and require the State to conduct itself honorably, reversing the decision on the pass-on defense and mandating that the State refund its illegal extraction.

The root of the State's argument is incongruously based in theories of unjust enrichment, attempting to prevent Petitioners from obtaining a windfall.[8] That the State would attempt to rely on an equitable theory with its hands soiled by the illegal taking of taxpayer money bespeaks an irony that should not be tolerated by this Court. Clean hands are required of those seeking equity; any government that illegally takes money and refuses to return it does not merit reliance on equitable concepts justifying its behavior.

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[8] See *Milwaukee Safeguard*, Appellate Court Order at p. 15.

IV. THIS COURT SHOULD ESTABLISH A BRIGHT-LINE LEGAL INCIDENCE RULE IN PLACE OF THE NON-STATUTORY PASS-ON DEFENSE.

COST acknowledges that for some tax impositions, there are legitimate questions in determining the proper party to receive a refund. COST suggests that the State look to the legal incidence of the tax as a bright line rule for making such determinations. The legal incidence of tax should govern instead of a non-statutory pass-on defense. This approach would recognize statutorily created exceptions where the relevant statutes permit or require taxpayers to add the tax on to each customer's bill.[9] A bright-line legal incidence test would avoid the sophisticated theoretical and factual inquiry, long proceedings involving massive evidence, and complicated theories warned of by this Court in *McKesson*. Such a test would put parties on clear notice regarding their ability to challenge a tax and obtain remedy for a state's unconstitutional imposition. By adopting such a rule, this Court can guarantee the appropriate constitutional protections for taxpayers located or doing business in the State. On its own, the State here has provided no relief, no meaningful remedy; and, although its efforts may be construed as backwards, they are not backward-looking in a constitutionally significant way. This Court's review is critical to the preservation of constitution protections.

[9] Certain utility gross receipt taxes and some states' sales taxes (like the Illinois Retail Occupation Tax) have historically been imposed on the vendor but required or permitted to be passed through to the customer.

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CONCLUSION

For the reasons stated above, COST respectfully requests the Court to grant the Petition for Certiorari.

Respectfully submitted,

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